

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA ALLIANCE FOR FAIR COMPETITION	DOCKET NO. C-03-243
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ORDER AUTHORIZING STAFF REVIEW OF AUDITS

(Issued September 20, 2004)

On October 21, 2003, the Iowa Alliance for Fair Competition (Iowa Alliance) filed with the Utilities Board (Board) a written complaint relating to services performed by a competitive business division within MidAmerican Energy Company (MidAmerican), MidAmerican Services. The complaint suggests that MidAmerican may not be complying with applicable law regarding cross-subsidization of nonutility services by rate-regulated gas and electric utilities. MidAmerican Services offers an extended service protection plan (ESP) for major appliances.

The Iowa Alliance is a group of heating and air conditioning contractors and associates. The Iowa Alliance states that its members regularly provide the same type of service, such as inspection, repair, and maintenance of heating and cooling equipment, as provided by MidAmerican Services. The Iowa Alliance questions whether MidAmerican Services can perform the advertised services at the listed price unless it is using funds from sources other than revenue generated by the extended service protection plan.

The Iowa Alliance asked that the Board order an audit of the transactions related to nonutility services. Iowa Code § 476.81 grants the Board the authority to periodically audit nonutility services provided by rate-regulated electric or gas utilities. “Nonutility service” is defined by Iowa Code § 476.72(3) to include, among other things, the sale, lease, servicing, repair, or maintenance of gas or electric appliances and heating or cooling equipment.

On November 17, 2003, the Board issued an order requiring MidAmerican to submit additional information regarding any MidAmerican resources used by its affiliate in offering the ESP. MidAmerican filed responses on December 2, 2003. The following is a brief summary of the responses:

1. The ESP is a nonutility service offered by MidAmerican Services. The costs are recorded below the line to nonutility accounts in accordance with MidAmerican’s cost allocation manual. MidAmerican does not provide vehicles, service tools, or instruments to the ESP program. However, MidAmerican does provide two employees whose responsibilities directly support the ESP program. The costs of these two employees are charged to the unregulated business, MidAmerican Services. In addition, any costs relating to customer support are charged to MidAmerican Services and not MidAmerican.
2. No costs of providing the services of the ESP program are recovered through MidAmerican’s gas and electric rates.

3. All costs relating to billing, computer software, customer information, call center, information technology, credit, etc., are charged to below-the-line accounts through a monthly per-customer charge. This rate for 2003 was \$1.69 per month per ESP customer. The total charges were \$237,003. These costs are included in a line item on the customer's MidAmerican bill. Part of the charge is to cover the additional cost of including the line item.

4. The ESP program included one bill insert into the MidAmerican bill. The costs of this insert, including postage and associated costs relating to delivering the insert, were calculated based on a fixed and a variable component. The fixed component included customer service, programming, information technology, and legal costs while the variable component included the additional cost for postage. These costs were all charged below the line and are not part of the charges for regulated gas and electric service.

5. MidAmerican received one request from a third party to include a bill insert in MidAmerican's bill list. A Des Moines area HVAC dealer alliance requested this information. Since no bill insert information was provided, no action on the request has been taken.

Iowa Code § 476.78 provides, in part:

A rate-regulated gas or electric public utility shall not directly or indirectly include any costs or expenses attributable to providing nonutility service in regulated rates or charges. . .

The Board issued an order on January 16, 2004, inviting comments from interested parties on whether an audit should be performed and, if so, whether it should be limited to nonutility services provided by MidAmerican or whether it should be expanded to include an audit of MidAmerican's affiliate transactions pursuant to Iowa Code § 476.75. Responses were filed by the Consumer Advocate Division of the Department of Justice (Consumer Advocate) on March 17 and April 12, 2004, MidAmerican on May 14, 2004, and the Iowa Alliance on June 10, 2004.

Consumer Advocate urged that a comprehensive audit of nonutility services and affiliate transactions be performed. Consumer Advocate said that a comprehensive audit would offer economies of scale. In addition, because MidAmerican has been subject to a revenue sharing plan with its customers from 1996 that will not expire until 2010, an independent audit will show if MidAmerican has taken any actions that inappropriately reduce the amount customers receive in revenue sharing.

Consumer Advocate supplemented its response with information regarding a loan secured by MidAmerican Holdings, MidAmerican's parent, from its owner Berkshire Hathaway. While MidAmerican said in response to a data request from Consumer Advocate that none of this loan was attributable to retail gas or electric operations, Consumer Advocate said it was impossible to verify this statement without an audit. Consumer Advocate argued that the interest rate provided for in the loan was above the utility bond rate and could be used to improperly compute or

impact MidAmerican's rate for allowance for funds used during construction (AFUDC).

The Iowa Alliance filed comments supporting Consumer Advocate's position for a more comprehensive audit. A broad audit is needed to effectively trace cost allocations between the utility, nonutility services, and affiliates.

MidAmerican in its comments urges the Board to consider the costs versus the benefits in assessing how to proceed. Because of MidAmerican's revenue sharing plan, customers have a direct stake in the costs of an audit, which are assessed to the utility. In addition, internal and external audits of MidAmerican are already available, along with the cost allocation manuals required by 199 IAC 33.5. MidAmerican asserts that a key part of ensuring that there is no cross-subsidization of nonutility or affiliate transactions by the rate-regulated utility is a series of comprehensive internal and external audits. These audits are available for review by the Board and its staff.

MidAmerican states that external auditors complete a comprehensive independent audit of MidAmerican's Federal Energy Regulatory Commission (FERC) Form 1 to obtain reasonable assurance whether the financial statements are prepared in accordance with the FERC Uniform System of Accounts. This audit includes examining evidence supporting the amounts in the financial statements, including the classification of those costs as utility or nonutility. In addition, MidAmerican's internal audit department completes biennial reviews of affiliate transactions and periodically audits the costs charged to the ESP plan. Finally,

external auditors annually examine MidAmerican's compliance with its cost allocation manual for nonutility services.

MidAmerican urges that the Board and its staff utilize these existing audits to ensure that there is no duplication of work. If the Board decides to proceed with nonutility or affiliate transactions audits, MidAmerican provides several suggestions on how the audit and request for proposals should be structured.

The Iowa Alliance's complaint is focused on nonutility services, i.e., the ESP plan. Nonutility services are offered by MidAmerican Services, a division of MidAmerican, the regulated utility. The ESP program is not offered by a MidAmerican affiliate and the Board does not believe the complaint warrants a comprehensive independent audit of all affiliate transactions. Consumer Advocate's concern about the debt incurred by MidAmerican Holdings Company from Berkshire Hathaway and its possible effect on AFUDC rates does not justify the cost of a full utility audit at this time. Any concerns that MidAmerican is using a rate not justified by the AFUDC rules should first be the subject of discussions between MidAmerican and Consumer Advocate. If significant concerns persist after those discussions, a complaint focused on that issue could be filed with the Board.

The responses provided by MidAmerican to the Board's inquiries on November 17, 2003, allayed several of the Board's concerns. No evidence has subsequently been filed to suggest cross-subsidization of nonutility services by the regulated utility. The Board is also mindful that an audit, which would be paid for by MidAmerican pursuant to Iowa Code § 476.81, is expensive and could reduce the

amount available to ratepayers under MidAmerican's approved revenue sharing plan. However, the Board also recognizes that it is important that the Iowa Alliance and MidAmerican's other ratepayers be assured through an independent analysis that there is no cross-subsidization of nonutility services.

The Board believes the best balancing of the various interests at this time is to have its staff review the comprehensive internal and external audit reports referred to by MidAmerican in its response. Consumer Advocate will be provided an opportunity to be part of that review. Review of the audit reports themselves will not be sufficient. The Board's staff will also need to review the workpapers supporting the audits, particularly with respect to the compliance audit and the cost allocation manual. Other documents may also need to be reviewed and explained. MidAmerican will be required to make its personnel available to assist the Board's staff and Consumer Advocate in locating and assembling the workpapers and other documents the Board's staff and Consumer Advocate deem appropriate for their review. MidAmerican personnel will also be required to answer any questions the reviewers have regarding the audits or supporting documents. After this review is complete, the Board retains the option to order a comprehensive audit if all significant concerns are not adequately addressed.

It is important to emphasize that the external audit reports are prepared by independent auditing companies and that their review and final work product is not dictated by MidAmerican. Particularly in light of the substantial costs of an audit, the Board believes it is reasonable to have its staff conduct a review of this independent

work product before ordering a separate audit. At a minimum, this review should help focus any audit that may be subsequently ordered.

The Iowa Alliance notes that cross-subsidization of nonutility services was found by the Board to exist in the early 1990's after an audit was performed on Peoples Natural Gas Company, n/k/a Aquila, Inc. However, since that audit was performed, the Board has adopted administrative rules governing nonutility activities record keeping and cost allocation. These rules adopt many of the audit's recommendations. The Board believes these rules have reduced the possibility of cross-subsidization. However, if the Board's staff review uncovers evidence of cross-subsidization, the Board will not hesitate to order a comprehensive audit.

The Board will appoint Wes Bridgeman, a staff member currently in the Energy Section but formerly an auditor for the Board, to lead the review. MidAmerican will be required to contact Mr. Bridgeman within seven days of the date of this order to schedule times for the review to begin. If Consumer Advocate desires to participate in this review, it should also contact Mr. Bridgeman within this time frame. The Board anticipates that this initial review will be completed in approximately 90 days.

IT IS THEREFORE ORDERED:

MidAmerican Energy Company is directed to contact Utilities Board staff consistent with this order and staff will conduct a review of the external and internal audits, including workpapers, regarding MidAmerican's nonutility services.

MidAmerican shall cooperate with this review, which may include Consumer Advocate, as set forth in the body of this order.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 20th day of September, 2004.